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N. BAGAVATHY AMMAL

v.

COMMISSIONER OF INCOME TAX, MADURAI AND ANR.

JANUARY 27, 2003

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[RUMA PAL AND B.N. SRIKRISHNA, JJ.]

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Income Tax Act, 1961; Sections 2 (14), 45, 46(2), 47, 48 and 256(1): Agricultural land received by assessee/shareholder on distribution of assets of a company in liquidation—Exclusion of value of such agricultural lands in computing capital gains from levying of Income tax—Held, object of introducing Section 46(2) was to broaden the base of incidence of capital gains and expressly providing for receipts of assets on distribution of share by a company in liquidation as taxable event—Hence, assessee is liable to pay tax on the market value of such agricultural lands—Income Tax Act, 1922 s.12-B.

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Transfer and distribution of assets of the company in liquidation—Distinction between—Discussed.

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The Appellant-assesseees were sisters. They received their share including agricultural lands by distribution of the assets of a company in liquidation during the assessment year 1970-71. The Assessing officer included value of such agricultural lands, in the income of assesseees subject to capital gains and accordingly levied income tax thereon. The Commissioner of Income Tax (Appeals) allowed the appeals. The Income Tax Appellate Tribunal negatived the appeal of the Revenue. At the instance of the Revenue, the Tribunal referred two questions of law on the issue of inclusion of the value of agricultural lands received as share by distribution of assets of a company in liquidation, whether such income be included in the income of assesseees subject to capital gains and levying of tax thereon. However, only one of the questions was pressed which was decided by the High Court in favour of Revenue. Hence the present appeal.

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The question which arises in these appeals is whether the term 'assets' in Section 46(2) of the Act must be understood and construed according to the definition of the term capital assets in Section 2(14) of the Income Tax Act.

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Dismissing the appeals, the Court

HELD: 1.1. Section 12-B of the Income Tax Act, 1922 provided for payment of tax under capital gains 'in respect of any profits or gains whatsoever from the sale, exchange, relinquishment or transfer of a capital assets, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place. Section 45(1) of the Income Tax Act, 1961 continues to provide the same. [618-D-F]

1.2. The object in introducing Section 46(2) in the Income Tax Act, 1961 was to broaden the base of the incidence of capital gains and to expressly provide for receipt of assets of a company in liquidation by a shareholder as a taxable event. Section 46(2) is an independent charging Section. [620-D]

Commissioner of Income Tax v. Madurai Mills Co. Ltd., (1973) 89 ITR 45 and *Commissioner of Income Tax v. R.M. Amin*, [1977] 1 SCC 691, 696, relied on.

1.3. A distinction is drawn between a transfer of assets and a distribution of assets of the company on liquidation. Where there is 'transfer' of assets and not a 'distribution' on liquidation then having regard to Section 47(viii), a transfer of agricultural land by the company may arguably be exempt from capital gains. However, such exemptions are not available to shareholders who receive assets from the company on distribution consequent upon liquidation because of provisions of Section 46(2) of the Act which was introduced to make the receipts of assets from a company in liquidation by its share holders a taxable event for the first time. [619-D-F-G-H]

1.4. Having referred to the use of the phrase 'capital asset' in Sections 45(1), 47 and 48 of the Act, Parliament appears to have deliberately chosen to use the word 'asset' in Section 46(1) and (2) of the Act, the ostensible intention being to bring assets of all kinds within the scope of the charge. The High Court rightly held that agricultural land would have been a 'capital asset' but for the exclusion from the definition of 'capital asset' and what is not a capital asset may yet be an asset for the purposes of Section 46(2) of the Act. Therefore, to the extent that a shareholder assessee receives assets whether capital or any other from the company in liquidation, the assessee is liable to pay tax on the market value

A of the assets as on the date of the distribution as provided under Section 46(2). The invocation of Section 2(14) of the Act which defines "capital asset" is as such unnecessary for the purpose of construing Section 46(2) of the Act. [620-G-H; 621-A-B-C]

B CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2606-7 of 2001.

From the Judgment and Order dated 25.3.1999 of the High Court of Madras in T.C. 292 and 293 of 1988.

C T.L.V. Iyer, Subramonium Prasad, Abhay Kumar and R. Gopalakrishnan, for the Appellants.

Rajiv Tyagi and B.V. Balramdas, for the Respondents.

The Judgment of the Court was delivered by

D **RUMA PAL, J.** The question to be decided in these appeals is whether the word 'assets' in Section 46(2) of the income Tax Act, 1961 (referred to hereafter as the 'Act') must be understood and construed according to the definition of the word 'capital assets' in Section 2(14) of the Act.

E The issue arises in respect of the assessment year 1970-71. The appellants in the two appeals which are disposed of by this judgment are sisters. They were share holders in M/s Palkulam Estate (Private) Ltd., Nagercoil (referred to hereafter as the 'Company'). The Company went into liquidation in 1964. Pursuant to a compromise decree dated 22nd December 1969 in litigation between the assesseees and their brother (who was also a share holder in the company), and the company represented by the liquidator, the assets of the company which included agricultural lands were distributed to the appellants and eight others. The compromise decree stated.

F "This Court doth further order and decree that as far as liabilities of Plkulam Estate Private Limited is concerned. the immovable properties be and hereby are distributed as indicated in Schedule 'A' of the Compromise. The respondents 1 to 5 and respondents 9 to 11 do get leased portion as shown in the plans, signed by liquidator Mr. K.M. Boothalingam Pillai and handed over to the appellant this day".

G The appellants thereby received 479.89 acres of the agricultural lands **H** prior to the end of the relevant accounting year that was 31.3.70. the assessment

in respect of the year 1970-71 had been completed on 27.2.71. The Income Tax Officer reopened the assessments under Section 148 of the Act. The appellants filed their returns in respect of the two notices under Section 148. The contention of the appellants that in terms of the definition of 'assets' in Section 2(14), agricultural lands were entitled to be excluded while computing capital gains on assets received by the shareholder from a company in liquidation under Section 46(2) was not accepted. According to the assessing officer, Section (46)2 refers only to money received on liquidation or the market value of the assets on the date of distribution and it was immaterial whether the asset was agricultural lands or otherwise. The value of the share of agricultural lands transferred to each appellant was, therefore, included as income subject to capital gains and subjected to tax. The assessee's appeals before the Commissioner of Income Tax (Appeals) were allowed by holding that the scope of Section 46(2) would have to be read in the light of the definition of the word 'capital asset' in Section 2(14) and that "having exempted agricultural lands from capital gains under the general provision, it was difficult to interpret Section 46(2) as including agricultural land". The action of the Income Tax Officer in charging the income of the distribution of agricultural lands as capital gains under Section 46(2) of the Act was according set aside.

The Revenue appealed before the Tribunal. The Tribunal dismissing the Revenue's appeal held :

"On a combined reading of Section 45, 46(2) and 48 it will be clear, according to our opinion, that assets mentioned in Section 46(2) would mean capital assets. In as much as Section 47 (viii) exempts transfer of agricultural lands from capital gain tax under Section 45, we agree with the Commissioner of Income Tax (Appeals) in coming to the conclusion that it is difficult to interpret Section 46(2) as including agricultural lands which is outside the scope of the income Tax."

Of the two questions referred to the High Court by the Tribunal under Section 256(1) at the instance of the Revenue only one survives for our decision. The second question was not pressed before the High Court. The first question which was:

"Whether on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in holding that the assets mentioned in section 46(2) would mean 'capital asset' as defined in section 2(14) and that consequently, the value of agricultural lands received

A by the assessee on the liquidation of Palkulam Estate (P) Ltd. cannot be charged to tax under section 46(2) of the income Tax Act, 1961?"

was answered by the High Court against the assessee and in favour of the Revenue. The High Court construed the provisions of Section 46(2) and held, reversing the decision of the CIT(A) and the Tribunal, that the definition of 'capital assets' under Section 2(14) of the Act is not of any relevance for the purpose of construing Section 46(2) of the Act, and the fact that agricultural lands to the extent provided in Section 2(14)(c) of the Act are excluded from the definition did not have any impact on the taxability of the market value of the agricultural lands received by the assessee on the distribution of the assets of a company in liquidation.

Before considering the correctness of the decision of the High Court the context in which Section 46(2) came to be part of the Act needs to be considered.

D Section 12-B of the Income Tax Act, 1922 provided for payment of tax under capital gains 'in respect of any profits or gains whatsoever from the sale, exchange, relinquishment or transfer of a capital asset effected after 31st day of March 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place". Construing Section 12-B of the Income Tax Act, 1922 this Court in *Commissioner of Income Tax, Madras v. Madurai Mills Co. Ltd.*, (1973) 89 ITR 45 had held that when a shareholder receives money representing his share on distribution of the net assets of the company in liquidation, he receives that money in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to sale, exchange, relinquishment or transfer within the meaning of Section 12-B of the Act.

Section 45(1) of the 1961 Act which substantially corresponds with Section 12-B of the 1922 Act continues to provide that:

G "Any profits or gains arising from the *transfer* of a capital asset effected in the previous year shall, save as the otherwise provided in Sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H be chargeable to income tax under head 'Capital gains', and shall be deemed to be the income of the previous year in which the transfer took place."

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The words 'capital assets' has been defined in Section 2(14) of the Act which as it stood at the relevant time, that is prior to its amendment in 1972, provided. A

"2. In this Act, unless the context otherwise requires

.....

(14) 'Capital assets' means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include B

(i)

(iii) agricultural land in India C

It has been held by this Court that the principle of *Madurai Mills* that a distribution of assets of a company in liquidation does not amount to a transfer continues to apply to the 1961 Act. See *Commissioner of Income Tax v. R.M. Amin*, [1977] 1 SCC 691, 696. D

The view in *Madurai Mills Co. Ltd.*, (supra) has also been statutorily affirmed in Section 46(1) which provides:

46. (1) Notwithstanding anything contained in section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45. E

In other words a distinction is drawn between a "transfer" of assets and a distribution of assets of the company on liquidation. Whether there is 'transfer' of assets and not a 'distribution' on liquidation then having regard to Section 47(viii) which provides that "Nothing contained in Section 45 shall apply to the following transfers : F

(viii) any transfer of agricultural land in India effected before the 1st day of March 1970." G

it may have been argued at least on behalf of the Company that the 'transfer' having been concluded in 1969 was exempt from capital gains. This argument, however, is not available to the shareholders who receive assets from the company on distribution consequent upon liquidation because of Section 46(2) which was introduced to make the receipts of assets from a company liquidation by its share holders a taxable event for the first time. Section H

A 46(2) provides :

“46(2) where a shareholder on the liquidation of a company receives any money or other *assets* from the company, he shall be chargeable to income tax under the head ‘Capital gains’ in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of sub-clause (c) of clause (22) of section 2 and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.”

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The question is does the words ‘assets’ in Section 46(2) mean ‘capital assets’ as defined in Section 2(14) of the Act? If it does then, it is conceded by the Revenue, there is no question of subjecting the agricultural lands received by the assessee from the company in liquidation to capital gains.

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Indisputably, the object in introducing Section 46(2) was to overcome the reasoning in *Madurai Mills* by broadening the base of the incidence of capital and expressly providing for receipt of assets of a company in liquidation by a shareholder as a taxable event.

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Section 46(2) is in terms an independent charging Section. It also provides for a distinct method of calculation of capital gains. As said in *C.I.T. v. R.M. Amin*, (supra) :

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“The aforesaid section, in our view, was enacted both with a view to make shareholders liable for payment of tax on capital gains as well as to prescribe the mode of calculating the capital gains to the shareholders on the distribution of assets by a company in liquidation. But for that sub-section as already mentioned, it would have been difficult to levy on capital gains to the shareholders on distribution of assets by a company in liquidation.”

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The Section does not make any reference to capital assets either in connection with the imposition of capital gains tax for its computation.

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Having referred to ‘capital assets’ in Section 45(1), 47 and 48, Parliament appears to have deliberately chosen to use the word ‘asset’ in Section 46(1) and (2), the ostensible intention being to bring assets of all kinds within the scope of the charge. It is not necessary to refer to a dictionary to hold that capital assets are a species of the genus ‘assets’. If the words ‘capital assets’ and ‘assets’ the used in Section 45(1) and 46 respectively did not overlap

then there was no need to provide for a non obstante clause in Section 46(1) with reference to Section 45. As correctly held by the High Court agricultural land would have been a 'capital asset' but for the exclusion from the definition of 'capital asset' and what is not a capital asset may yet be an asset for the purposes of S.46(2). A

Therefore, to the extent that a shareholder assessee receive assets whether capital or any other from the company in liquidation, the assessee is liable to pay tax on the market value of the assets as on the date of the distribution as provided under Section 46(2). The appears to be the plain meaning of the section and we see no reason to construe it in any other fashion. The invocation of Section 2(14) of the Act which defines "Capital asset" is as such unnecessary for the purpose of construing Section 46(2). B C

We accordingly dismiss the appeals without any order as to costs.

S.K.S.

Appeals dismissed.